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Quarterly Bulletin on Soviet Economic Growth



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Third Quarter 1986

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SOV SEG 86-004
November 1986

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Third Quarter 1986

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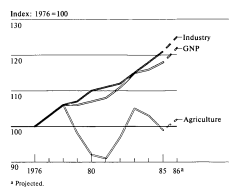
Economic Growth Rises, But Modernization Lags

A. Economic Performance Has Improved in 1986

Soviet economic performance in 1986 has continued much of the improvement attained in the second half of 1985. On the basis of preliminary information, we project that GNP will grow by 3 to 3.5 percent this year, a rate more than twice that of 1985, and industrial production by 3.5 to 4 percent, the fastest growth since the mid-1970s. A strong recovery in agriculture as well as short-term gains from better management and labor discipline account for much of the improvement.

Nonetheless, the leadership is not satisfied with progress in modernization. The machinery sector, the key to longer term growth, is not meeting its goals for output quality, product mix, and deliveries. As a result, investment is behind its ambitious schedule. Rapid progress in raising the quality and quantity of new and refurbished manufacturing capacity is essential if modernization is to be a major source of growth by the end of the decade.

Consumers have benefited this year from faster growth in retail trade, including some improvement in

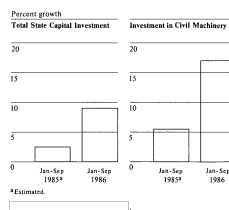


the availability of food and personal services. Nevertheless, plans for housing construction and improvement in other aspects of consumer welfare are not being met.

D. Capital Investment Growth Speeds Up

Investment growth over the first nine months of 1986 accelerated sharply from that of 1985. State capital investments for 1986 were up 9 percent during the first nine months; in 1985 investment growth in the corresponding period was at most 3 percent. This difference is even greater in commissions of new capacities: growth in the first nine months of this year was 12 percent, whereas growth in the same period in 1985 was 1 percent.

Investment rose by an impressive 17 percent in the first nine months of 1986 in the high-priority civilian machine-building sector. Although a substantial shortfall from Soviet plans, it still is a sharp acceleration over past performance. Some of the machinery ministries in this sector are reported to have assimilated startlingly high increases in investment, in the range of 20 to 35 percent. The surge of investment in 1986 in the face of a much slower growth in domestic machinery production could be explained by a possible drawdown in uninstalled equipment, an increase in net imports of capital goods, some success in the Soviet campaign to curb the rise in capital repair, or some falsification in investment reporting. The possibility that growth in the production of military hardware has been scaled back cannot be ruled out.

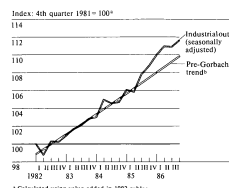


*Estimated.

B. Industrial Growth: Energy and Basic Materials Sectors Perform Well

Industrial production in the first three quarters of 1986—estimated from official statistics—was about 4 percent higher than output in the same period of 1985. Third-quarter growth over second-quarter, seasonally adjusted, however, is only 2 1/2 percent, better than last quarter, but lower than last year's 3 1/2 percent in the third quarter.

Growth in energy production was good, albeit at steeply rising cost in investment. After faltering badly in 1984 and 1985, oil production is at the highest level in two years. Because of seasonal low demand in summer, the loss of electricity-generating capacity caused by Chernobyl¹ did not seriously disrupt the economy. Solid gains in output of basic materials—metals, chemicals, cement, and timber—have been complemented by improvements in rail transportation, facilitating growth throughout industry. In keeping with the campaign to reduce alcohol consumption, state production of liquors, vodka, and wine dropped by more than one-third. Although private production rose somewhat, General Secretary Gorbachev's antialcohol campaign appears on track.



* Calculated using value added in 1982 rubles.
* Average annual growth from second quarter 1982 through time quarter 1985 (12.2%).

E. Producer Durables: Concern Over Quality and On-Time Delivery

Despite respectable output growth, about 4 percent so far this year, the machinery sector was singled out for criticism in the official announcement on third-quarter performance. Six civilian machine-building ministries that build industrial equipment were cited for shortfalls in specific areas. Further, the Ministry of Radio Industry (one of the nine defense-related industrial ministries) was singled out for failing to fulfill its output plan.

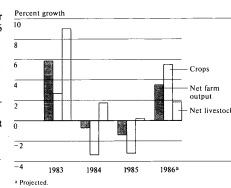
The nature of the criticism of machinery output performance clearly focuses on two issues—product quality and timely delivery of specific, contracted products—rather than on overall numbers. The potential snowballing effect of delivery failures at large investment projects is probably the prime concern eliciting this criticism. In fact, despite the increase in growth of commissions this year, additions to capacity are still substantially behind plan. Additions to capacity are an important measure of modernization because they represent the introduction of new producer durables that should embody higher technical standards.

Ministry	Criticism
Machinery overall	Failure to meet contract obligations
Ministry of Heavy and Transport Machine Building	Arbitrary production (producing more than one-third of its monthly output in the last few days of the month)
Ministry of Machine Building for Light and Food Industry	Poor quality of products
Ministry of Chemical and Petroleum Machine Building	Did not meet goals of Scientific-Technical Program
Ministry of Tool and Tool Building Industry	Shortfalls in blast furnace and steel-making equipment, continuous billet casting equipment, and freight cars and passenger cars
Ministry of Electrical Equipment Industry	Shortfalls in production of chemical equipment
Ministry of Machine Building for Light and Food Industry	Cost-reduction targets not met for forge and press machinery
Ministry of Automotive Industry	Shortfalls in AC electric motors
Ministry of Machine Building for Light and Food Industry	Shortfalls in selected consumer durables and equipment for light industry
Ministry of Automotive Industry	Shortfalls in trucks powered by liquefied and compressed gas

C. Upturn in Farm Output

Recovering from the downward slide experienced over the past two years, overall agricultural output in 1986 probably will match or possibly exceed the previous record achieved in 1983. We estimate that grain output will be about 195 million metric tons, but in a recent speech party secretary Ligachev cited a figure of about 210 million. In either case, the crop will be above last year's officially reported 191.6 million tons. We estimate total farm output will be up by about 3 percent but could grow as much as 4 percent if Soviet claims for grain output hold up. Although drought conditions hurt some crops, mild temperatures and adequate precipitation in the major potato- and vegetable-growing areas boosted their production well above the depressed 1985 level.

General Secretary Gorbachev's strategy of increasing meat production through productivity gains rather than through herd building is paying off. By September, production of meat on state and collective farms was running 7 percent ahead of last year even though the number of animals was almost unchanged. In addition to a good grain harvest, production of hay



and other major forage crops will be close to previous highs, ensuring further growth in meat production and reducing the immediate need to import grain for livestock feed.

F. Glasnost: What Does It Mean for Economic Analysis?

Gorbachev's policy of glasnost—openness—is apparently reversing a 15-year trend toward reducing the amount of economic information officially released. Several data series reappeared in the most recent Soviet statistical annual, and the report on plan fulfillment for the first three quarters of 1986 had nearly as much detail on performance as in a usual annual plan report. Gorbachev is using glasnost to enhance leadership credibility and promote his own goals.

There are signs, however, that the quality of some Soviet data may be deteriorating. The Soviets themselves are cracking down on falsification in plan fulfillment reporting. Incidents involving false reports by party officials and managers have been publicized in the construction, railway, and machine-building ministries. Moreover, in the annual statistical abstract, figures concerning personal consumption show inconsistencies that imply an attempt to cover up a shortfall in real growth of consumption through manipulation of retail price indexes.

In what way can we regulate ourselves: only through criticism and self-criticism. Most importantly, through openness.

M. S. Gorbachev to the writers union in June

Included among the restored or new data series in the 1985 yearbook are:

- Health indicators for life expectancy and infant mortality.
- Alcohol production and sales.
- Grain production and sales by type.
- New international comparisons.

The report on plan fulfillment for the first three quarters of 1986 also included more detail on performance than in the past:

- Investment and commissioning growth by ministry.
- Growth of "national income produced."
- Growth of investment in machine building.
- Growth of retail sales of individual commodities.

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